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European Review

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17 July 1985

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European Review

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Eastern Europe: Uncertain Economic Recovery

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East European economic performance improved in 1984, but the likelihood of a sustained recovery is not great. Most of the growth resulted from large gains in agricultural output due to good weather, not a surge in industrial production. Although the region seems to be recovering from the harsh winter weather, growth rates probably will fall below last year's level. Over the long term, external constraints and systemic weaknesses will make it difficult for the region to return to the generally good economic performance of the early 1970s.

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Economic News in Brief

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Some articles are preliminary views of a subject or speculative, but the contents normally will be coordinated as appropriate with other offices within CIA. Occasionally an article will represent the views of a single analyst; these items will be designated as uncoordinated views. Comments may be directed to the authors.

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Briefs

West Germany

Post-Bitburg Polls

The President's Bitburg visit apparently improved West German public views of the United States, at least temporarily. Elisabeth Noelle-Neumann, head of the Allensbach polling firm and a frequent adviser to Chancellor Kohl, wrote recently that the President's popularity in West Germany had increased dramatically. The percentage of respondents who say they like Americans and favor close cooperation with the United States also rose after declining significantly since 1982.

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We doubt, however, that the changes will be deep or lasting. The President's popularity in West Germany also rose after his Bundestag address in early 1982, only to fall sharply within about six months. Further, the percentage of respondents who favor close cooperation with Washington still is lower than in the late 1970s and early 1980s. The presidential visit apparently had no impact on Chancellor Kohl's sagging popularity: an Infratest survey published in early July gave Kohl the worst personal popularity rating of any chancellor since the firm began polling in 1970. The same survey showed the Social Democrats with a 9-point lead over the CDU/CSU.

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West Germany- East Germany

Model Agreement for a Chemical-Weapons-Free Zone

After more than a year of discussion, West Germany's opposition Social Democrats and East Germany's Communist party have concluded a model agreement for a chemical-weapons-free zone in Central Europe. The document—which the parties intend to submit to their respective governments—proposes prohibiting the production and stationing of chemical weapons in an area encompassing, ideally, those states defined at the MBFR talks, or at least the two Germanys and Czechoslovakia. Verification would be conducted by an international commission composed of treaty signatories; details of how this commission would work was left for future negotiations.

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By displaying an ability to work with the East Germans on a sensitive topic, the Social Democrats almost certainly hoped to capitalize on the popular aversion to chemical weapons in West Germany, as well as the absence of movement on arms control and intra-German affairs. The Kohl government continues to support NATO's policy of working toward a verifiable global chemical weapons ban at the Conference on Disarmament in Geneva, and Bonn has had relatively little success in its talks with East Berlin this year on cultural, legal, scientific, and environmental matters. As yet, however, there has been surprisingly little public

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response, and government officials have confided to US diplomats that they do not believe the agreement will generate much public pressure on Bonn to alter its position on chemical weapons. The SPD has not given up though; [] a party delegation will initiate talks soon on a nuclear-weapons-free zone with the East German Communists []

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Netherlands**Van Mierlo's Return** []

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Hans Van Mierlo's apparent return to politics will probably boost the fortunes of the Democrats 66 party and may even enhance INF prospects. D'66, only four years ago riding a crest of popularity, into its first participation in a government coalition, has seen its standing sag badly as the party yawed between the Liberals on the right and Labor on the left. D'66 leaders desperately wanted Van Mierlo, one of the party's founders and a charismatic leader by Dutch standards, to return to the leadership as the most immediate way to recoup lost ground. Van Mierlo left politics in 1982 largely due to personal problems, but has said he is willing to be D'66 "list leader" (that is, the party's candidate for the premiership or, more likely, for a major cabinet post should it enter the government) for the election likely next spring. []

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Van Mierlo's popularity, according to Embassy reporting, could add two to five seats to the six currently held by D'66 in the 150-member Second Chamber. While this number is small compared to Labor, the Christian Democrats, and the Liberals, D'66 could prove vital to putting together a new government, especially because polls show that majorities are unlikely for either a renewed center-right Christian Democratic-Liberal coalition or a Labor-led "progressive bloc" of leftwing parties. Van Mierlo's stand could be especially important in maintaining support for a positive INF decision; D'66 rank-and-file sentiment is strongly against INF, but, while Defense Minister in 1982, Van Mierlo became more sympathetic to the program and consented to preliminary basing preparations. In the past, Van Mierlo has expressed distaste for participation in a center-right government, but, given D'66's need for his leadership, he would have a strong hand should he decide to join the Christian Democrats and Liberals—and go along with INF deployment. []

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Belgium**Playing the Linguistic Card** []

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Belgian politicians are busily engaged in portraying themselves as stalwart defenders of their respective regions as the national election approaches. The opening salvos occurred in Wallonia last month, with the Walloon Social Christians, smallest party in the center-right coalition, threatening to bring down the Cabinet this fall by rejecting constitutional amendments to give regional authorities more power over education. Party leaders argue that decentralizing would place Catholic education at the mercy of the Walloon Socialists, who dominate politics in Francophone Belgium. Just as important a motive is the desire to use the emotional "school issue" to mobilize Catholic voters in the election, due by December. []

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The opposition Walloon Socialists, who would rather fight "Flemish imperialism" than the Social Christians, have countered by putting together an economic agreement with the French-language element of the socialist trade union confederation (the last major institution in Belgium not formally split into Flemish and Walloon branches). Walloon Socialist leader Guy Spitaels almost certainly realizes that some of the provisions on restoring social spending cuts and creating jobs are unrealistic and probably could not be implemented should the Socialists reenter a coalition cabinet after elections. Economic logic and sound policy, however, take second place to the electoral need for a united "Walloon front"—a lesson likely to apply equally to Flemish politics in the weeks ahead. []

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Sweden**Improving Command and Control** []

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Swedish armed forces continue to suffer command and control problems at the brigade and divisional level due to poor procedures and inadequate training.

[] the Swedes recently implemented changes in their training doctrine and operational procedures after several visits by ranking Swedish officers to US Army Europe Headquarters (USAREUR) and to the United States and West Germany to observe large-scale maneuvers. Other Swedish personnel have recently sought US assistance in developing computer-assisted war games for the Swedish Armed Forces Staff College. The objective is to complement field training, although the Swedes do not see the program as a complete solution to their training deficiencies. []

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Better training and new procedures may help alleviate command and control problems evident at the "East Coast" exercise in the fall of 1983, when poor coordination between ground and air command elements reportedly resulted in 12-to-14-hour delays before units were airlifted to designated drop zones. Increased reliance on US military assistance and cooperation also could broaden coordination between the US-Swedish military commands. Nevertheless, Sweden—as a nonmember of NATO—will continue to highlight its political and military neutrality as evidenced during the recent "Western Border" exercise where Swedish forces deployed to repel a hypothetical Western effort to seize airfields during an "East-West" conflict. []

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Poland**Cardinal Glemp Meets Exiled Leaders** []

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Jozef Cardinal Glemp took the unusual step of holding several meetings with leaders of the Polish Government-in-Exile in London during his 11-day visit to the United Kingdom in early March. Glemp visited various institutions tied to the London-based government and attended an official dinner where the main address was delivered by the exile premier. During a meeting with the aged Count Edward Raczyński, the president of the exile government, Glemp reportedly discussed the political situation in Poland, the problems of Polish emigres, and the difficulties of the Church program for aiding private agriculture. Before his return home, Glemp publicly referred to Raczyński as "Mr. President" and paid tribute to his intelligence and experience. []

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Some contact with exile politicians was probably unavoidable, but Glemp seems to have gone beyond what was necessary. He may have felt compelled to turn his stay in London into a virtual state visit to defuse criticism of his stewardship of the Polish Church by the emigre community in Western Europe—a subject he is reportedly sensitive on. In that sense, the event brought immediate results: an article in London's leading Polish newspaper attacking Glemp as being too accommodating to the regime was retracted with an apology after a stream of protest letters from irate readers. Glemp may also have calculated that paying homage to Raczynski would encourage Poles in the United Kingdom to press Britain to drop its opposition to West European funding for the agricultural fund. Glemp thus far has escaped criticism by the government-controlled media in Poland. Warsaw regularly ridicules the remnants of the prewar government as part of Western subversion of Poland, but remains highly suspicious of even unofficial contacts that question its sovereignty. A ceremony last spring in which Lech Walesa and his adviser, Father Henryk Jankowski, were awarded medals by the London government, provoked sharp attacks in the official Polish and Soviet press. []

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Bulgaria**Coping With Energy Problems** []

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Bulgaria's recently created Ministry of Energy is giving high priority to upgrading energy production facilities to prevent a recurrence of last winter's energy shortage, according to the US Embassy in Sofia. Energy Minister Todoriev has been involved in talks with Western firms specializing in energy-related technology, and, according to some Western businessmen, large hard currency outlays have been approved for modernization and construction of energy production facilities. []

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The need to increase imports of Western machinery and equipment is implicit in Bulgaria's investment plans, which emphasize energy efficiency and development of domestic energy sources. The ministry's action may reduce some of the bureaucratic inertia that has slowed major energy development projects. []

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[] the drawn-out negotiations on purchasing US technology for an anthracite mining project reflect a reluctance by decisionmakers to accept responsibility if the project is unprofitable. Nonetheless, Western imports will not solve the construction delays and shortages that have plagued large nuclear power and coal projects, nor enable Bulgaria to reduce significantly its dependence on the USSR for energy supplies. []

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Articles

**Western Europe-South Africa:
Attitudes on US Sanctions**

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Several West European allies that have often condemned apartheid are now sorting out whether they will emulate the United States if Washington invokes economic sanctions against South Africa.

colleagues, causing the British—according to US diplomats at the United Nations—to consider a demarche to Ottawa.

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France appears more interested in rhetoric—perhaps designed to curry favor with nonaligned countries—than in action. The Dutch support sanctions in principle but have not imposed them. West Germany has not yet had any role in the debate. Norway, on the other hand, has already implemented action against Pretoria.

But Reluctance To Apply Sanctions

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While West European governments are willing to censure South Africa, the passage of sanctions legislation by both houses of Congress has forced Allied governments to reexamine their willingness to take stronger action against Pretoria. The Allies almost certainly are concerned that their governments will face increased domestic public pressure for sanctions if Washington adopts a tougher policy. Some officials already have expressed their opposition to sanctions during private discussions with US officials and others.

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Annoyance With South African Actions

Allied leaders, through public statements and private demarches, have expressed irritation with the abortive South African raid against oilfields in Cabinda on 21 May and the attack against African National Congress personnel in Gaborone on 14 June. The British, in particular, believed that this adventurous behavior hurt London's efforts at diplomatic dialogue with Mozambique and Angola. In addition, one Canadian official drew the attention of US diplomats to the fact that Foreign Minister Clark condemned South African actions twice in an 18 June statement.

British Political and Economic Concerns. The US Embassy in London reports that the British are dismayed with South Africa's evident intention to resort increasingly to military action in disregard of Western political interests. Nevertheless, Prime Minister Thatcher remains opposed to sanctions and determined to protect highly profitable British investment and commercial ties to South Africa.

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West European members of the UN Security Council participated in a 15-0 approval of a resolution condemning the raid on Cabinda, although the British diplomats stated that their government believed calling it an "act of aggression" was too harsh. The British—but not the French—joined Washington in abstaining on another resolution, which passed the previous day 13-0-2, calling for a list of "appropriate voluntary measures," including "stopping of new investments" and prohibitions of Krugerrand sales. During the debate the Canadian Ambassador criticized South Africa more strongly than his

The British worry that Washington's policy will make it difficult for them to resist pressure to apply sanctions from parliamentary opponents and Commonwealth countries—which hold a summit in October. According to the US Embassy in London, Social Democratic leader David Owen is considering introducing a bill that would force Parliament to consider sanctions. Such action could lead to a divisive debate between anti-apartheid and probusiness Tories.

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British officials are attempting to reinforce US awareness of the disadvantages of sanctions. For example, London reportedly agreed with Ambassador Walters that disinvestment would hurt South African blacks, damage neighboring states, and enable South African hardliners to block progress toward dismantling apartheid. []

Disingenuous French Diplomacy. French policy has mixed public affirmation of a willingness to consider sanctions with private hope that the issue will go away. Prime Minister Fabius told a Paris human rights rally on 31 May—after Cabinda but before Gaborone—that France stands ready to curtail investment in South Africa if the latter does not ameliorate the apartheid system within 18 months. Fabius also declared—in principle—his willingness to upgrade relations with the South-West Africa People's Organization (SWAPO). France had previously given SWAPO an official status and an office in Paris. In July, Paris announced that it would not support export by French firms to South Africa of containers for nuclear waste and other nonsensitive items. []

In addition, the French adopted an anti-South African diplomatic posture for the benefit of non-aligned delegations at the United Nations. During the maneuvering that preceded the recent Security Council resolutions, French diplomats told US officials that Paris could accept stronger language on sanctions than Washington or London wanted. US diplomats reported that the French distanced themselves from other Western delegations and gave every indication of trying to “cut their own deal” with nonaligned delegations. The French reportedly did not coordinate their policies or tactics with other Western delegations until the last moment. []

Privately, however, the French take a more cautious line. Foreign Ministry officials told Ambassador Walters on 4 June that they considered sanctions unlikely and hoped the issue could be avoided. []

The Dutch Are Cautious. The Hague has been put in an awkward position because at least one Dutch national reportedly was killed during the South African raid on Gaborone, and the editor of the Dutch

newspaper *Trouw* was arrested briefly by South African police on 25 June after spending a morning in a black township. The attack on Gaborone coincided with the completion of a Dutch Government report supporting in principle multilateral investment sanctions, but rejecting them in practice because they have insufficient international backing. The government, which presented the report to parliament on 18 June, promised to maximize the “stimulating effect” of international investment on the emancipation of black workers. In addition, it called for legislation making it mandatory for Dutch firms to comply with the EC Code of Conduct regarding their investments in South Africa. []

The report denied the possibility of immediate unilateral sanctions. Parliament had asked the government to consider restrictions on petroleum exports to, and coal imports from, South Africa, but the report stated that such action is prohibited by GATT, EC regulations, and a bilateral agreement with Pretoria. The government claimed that it had lobbied hard in the United Nations for a mandatory oil embargo, but complained that Security Council action appeared unlikely. While government spokesmen implied that they might stiffen their position if the US Congress approved economic sanctions, differences within the ruling coalition and between the government and opposition parties—according to the US Embassy in The Hague—blocked agreement to join US measures. []

Nevertheless, continued South African aggressiveness might provoke harsher Dutch reaction. South African authorities apparently violated Dutch Embassy grounds while arresting an escaped prisoner—a Dutch anthropologist—on 10 July. South African officials told US diplomats that the fugitive is a terrorist; press sources suggest that The Hague might recall its ambassador from South Africa over the incident. []

So Are the Canadians. Canada announced on 6 July a series of relatively moderate measures, including abrogation of the Canada-South Africa double

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taxation agreements. According to the US Embassy in Ottawa, these steps are meant to signal Canada's moral position while avoiding stronger economic sanctions. Predictably, at least one opposition spokesman has called Ottawa's action "a joke." Press commentary also has portrayed it as weak. []

Norwegians Taking Action. Norway has sanctions in place and, in contrast to its Allies, was preparing for further action even before the Gaborone raid. On 7 June, the parliament approved a government white paper toughening the following restrictions:

- An embargo on export of Norwegian oil.
- No nuclear cooperation.
- No bilateral sports contacts.
- No Norwegian Government approval of capital exports for investment in South Africa.
- Visa requirements for South African nationals seeking to visit Norway.
- Humanitarian aid for some liberation movements and refugees.
- Direct Norwegian funding of projects designed to reduce other countries' dependence on South Africa.

[]

In addition, parliament condemned the "politically illegitimate" South African Government and directed the cabinet to evaluate a wide spectrum of additional sanctions. These include banning imports of South African military equipment into Norway and forbidding the export of materials to South Africa that could be used militarily. While supporting UN trade sanctions against South Africa, parliament recognized that such restrictions lack adequate international support. []

On 26 June, Norway, Sweden, and Denmark announced cancellation of their air traffic agreement with South Africa. Scandinavian Airlines System's flights to South Africa—which airline officials describe as relatively unprofitable—will halt within six months, according to press sources. []

Outlook

Pretoria's military policies and the resulting debate in the US Congress are forcing West European governments to face the contradictions in their policy toward South Africa. Allied governments—and particularly the British—are concerned that they may

no longer be able to deflect antiapartheid activists and Third World governments with pleas that West Europeans can do little by themselves to constrain South Africa. Prime Minister Thatcher—despite her dislike of South African leaders—will continue to protect British economic interests by seeking to avoid sanctions legislation, but could face major embarrassment if London takes an isolated action in blocking sanctions. []

The French probably will continue to support sanctions verbally—largely for the benefit of nonaligned countries—but are unlikely to take any direct action until after Washington clarifies its stance. The Dutch, who almost point to Washington as the necessary element in any future international sanctions regime, will face increased domestic pressure to stiffen its antiapartheid policies if the United States invokes sanctions. No other ally currently appears ready to follow the Norwegian lead, and all will probably protect their particular economic ties to South Africa unless and until international trade restrictions come into force. []

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Portugal: Reconciling Counterterrorism and Civil Liberties

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Concerned about the limited intelligence and resources available to combat terrorism and to control the activities of foreign agents, the Portuguese Assembly last fall gave preliminary endorsement to two security bills. One sets up new intelligence services and the other establishes procedures for internal security. Legislation in Portugal is subject to debate and modification after passage by referendum and the internal security bill is still being revised in committee. President Eanes, however, signed enabling legislation last month spelling out the specifics of the country's first civilian intelligence service since the 1974 revolution.



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Signs on a wall on Alexandre Herculano Street point out the headquarters of the intelligence services. The signs on the wall say: "The new PIDE already has a headquarters" and "No to the Insecurity Law."

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Until recently, memories of the internal security service¹ of the Salazar-Caetano dictatorships and the economic problems faced by a succession of weak governments prevented serious attention being given to intelligence. The need for an intelligence apparatus, however, became increasingly apparent as domestic and foreign terrorists grew more active. The principal indigenous group known as the Popular Forces of 25 April (FP-25), a relatively small faction with limited goals, appeared on the scene in 1980. The FP-25 carried out bombings and robberies while claiming to defend the rights of workers and farmers against the government and capitalist institutions. The real impetus for legislation, however, came from foreign terrorist attacks. In 1983, the assassination of PLO leader Isam Sartawi at a Socialist International congress in April and an Armenian assault on the Turkish Embassy in July alarmed the Portuguese Government and forcibly demonstrated the need for security legislation.

Ghost of the PIDE

The government intended to pass the internal security and the intelligence service bills in tandem as a comprehensive package of security legislation. The outlook for both bills initially seemed promising as the Socialist-Social Democratic government of 1983 was the first coalition since the revolution with a solid majority in the Assembly. There was also public support. A poll taken by a Lisbon newspaper in May 1984 showed about half of those interviewed expressed agreement with the need to create an intelligence service. An overwhelming majority, however, rejected such activities as opening of mail (90 percent against) or telephone taps (86 percent against).

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¹ The secret police in Portugal were known as the PIDE (International Police for the Defense of the State) from 1945-69 under Salazar, and as the DGS (General Security Directorate) from 1969 until abolished in 1974. Never large in numbers, the PIDE relied on informers—said at one time to be one person in 90—and on rumors of its omnipresence to uncover and control any group threatening the status quo. While the myth of its efficiency exceeded the reality, it employed various forms of psychological and physical torture and sent hundreds of regime opponents to prisons in Portugal, the Azores, and the African colonies.

The Internal Security Legislation

The government's original bill went far beyond what the public could accept. It gave the Minister of Internal Administration widespread authority to conduct searches and seizures, institute wiretaps, open

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mail, and prohibit public gatherings—all without judicial approval. Public reaction was immediate and extremely negative. The Communists were quick to draw parallels with PIDE powers. Even Socialists such as Sottomayor Cardia, a close colleague of Prime Minister Soares, saw it as an infringement on civil liberties. [REDACTED]

Nevertheless, the internal security bill passed on 27 July by a vote of 138 to 79 with two absentions, but seven Socialists broke ranks and voted against the bill, some 25 of the PSD deputies who voted for it demanded changes in committee, and President Eanes threatened to veto it. Extensive revisions of the bill have since been made in committee and judicial oversight provisions have been included, but the recent government crisis may ultimately delay final approval of the law. [REDACTED]

The Intelligence Services

The final voting on the intelligence services legislation last July went almost unnoticed after the more heated discussions on the internal security bill. As a safeguard against concentration of power, three separate services were created: a Strategic Defense Intelligence Service (SIED), a Military Intelligence Service (MIS), and the Security Intelligence Service (SIS). The SIED is charged with the collection, evaluation, and dissemination of intelligence related to internal security, while the MIS will produce the intelligence necessary for the national defense. The SIS, under the Ministry of Internal Administration, has primary responsibility for collecting foreign intelligence and preventing sabotage, terrorism, espionage, and other acts against the state. Coordination supposedly will be provided by a Superior Intelligence Council, assisted by a Technical Commission, but this group is so large it probably will only be used in an advisory capacity. There will also be an Oversight Council of three citizens elected by the National Assembly to monitor intelligence activities. [REDACTED]

Colleagues or Rivals?

Creation of the services will not immediately solve Portugal's intelligence collection problems. Initially, all of the services will suffer from a lack of trained professionals and equipment. Poor coordination, decentralization, and duplication of effort already hamper the efficiency of such local security forces as

The Security Intelligence Service

The SIS has primary responsibility for collecting and evaluating foreign intelligence and preventing sabotage, terrorism, espionage, and other acts against the state. It operates under the Ministry of Internal Administration [REDACTED]

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the Republican National Guard (GNR), the Public Security Police (PSP), and the Judiciary Police (PJ).

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Current Security-Related Forces

Public Security Police (PSP). National police force under the Ministry of Internal Administration charged with law enforcement in urban areas and airport and VIP security. Its Intervention Corps (CI) is a paramilitary force used primarily for crowd control. [REDACTED]
[REDACTED]

Special Operations Group (GOE). Reserve unit of the PSP that takes action only upon direction of the National Crisis Cabinet.^a Its primary mission is hostage rescue in terrorist situations. [REDACTED]
[REDACTED]

Republican National Guard (GNR). Responsible for maintaining order in rural areas, protection of government facilities, highway police functions, and some protection of dignitaries. The GNR is composed of 16,000 volunteers who have completed military service. Reasonably efficient, the GNR can handle minor disturbances. [REDACTED]
[REDACTED]

Judiciary Police (PJ). Under the Justice Ministry. The PJ deals with crimes against the state, bombings, kidnaping, drug trafficking, and other similar crimes. It investigates following terrorist acts, [REDACTED]
[REDACTED]

^a The National Crisis Cabinet is composed of senior government officials responsible for all policy decisions in a terrorist situation. The military acts in an advisory capacity. [REDACTED]

Nor can ingrained distrust between the military and civilian politicians be easily overcome. Over the past decade the question of who would control an intelligence apparatus has been a major stumbling-block facing the series of study groups that wrestled with the problem. Having separate military and civilian services may allay some apprehensions, but coordination among them is likely to prove cumbersome. [REDACTED]

Justice, Portuguese Style

The intelligence services are also likely to be demoralized by judicial laxity and Lisbon's poor record in prosecuting terrorist cases. The police claim the judiciary is subject to political pressure and vulnerable to terrorist threats. In one case, the FP-25 member arrested for murder was released, [REDACTED]

[REDACTED] In another, the killer of PLO leader Isam Sartawi [REDACTED]

[REDACTED] was acquitted of major charges and sentenced to three years for possessing a false passport. Although the verdict was annulled on technical grounds, the government again failed to prove its case in a second trial and the defendant, having already served most of a three-year sentence, may well be paroled and expelled from Portugal. [REDACTED]

Even if jailed, terrorists may not languish for long. In 1982, the Assembly twice rejected an amnesty law freeing members of the far-left Proletarian Revolutionary Party, prompting several of the prisoners to go on a prolonged hunger strike. The public, responding to the deterioration in their physical condition and accepting the argument that their bank robberies were politically motivated, pressured the Balsemao government into making concessions. [REDACTED]

Counterterrorist Outlook

While able to provide protection or mount an intervention operation, the Portuguese at present have no established counterterrorist policies and lack the

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manpower, financial resources, and experience to counter most terrorist threats in an effective manner. The SIS has moved into its new Lisbon headquarters [redacted] but any real intelligence capability is still several years away. Foreign agents can continue to penetrate Portugal's porous borders, and terrorist groups can attack low-risk targets with relative impunity. [redacted]

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Passage of the intelligence legislation is only a step in the right direction. Now the Portuguese must overcome internecine rivalries and force or cajole civilian and military services to share information and work together. The directors² heading up the services will need considerable political skill to smooth over the inevitable strains between the services and the government. Furthermore, the services must cope with public suspicion inherited from PIDE and face close scrutiny at first; any scandal or abuse of power will erode public support. The Portuguese, while acknowledging that a state must defend itself against terrorism, are determined to preserve personal freedoms. [redacted]

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Eastern Europe: Uncertain Economic Recovery

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East European economic performance improved in 1984, but the likelihood of a sustained recovery is not great. Most of the growth resulted from large gains in agricultural output due to good weather, not a surge in industrial production. Although the region seems to be recovering from the harsh winter weather, growth rates probably will fall below last year's level. Over the long term, external constraints and systemic weaknesses will make it difficult for the region to return to the generally good economic performance of the early 1970s. []

Growth in 1984

Eastern Europe's economic growth in 1984 accelerated for the second consecutive year. The CEMA 6¹ achieved a 3.1-percent growth rate in GNP, up from 1.6 percent in 1983. Growth ranged from Poland's 3.4 percent to Hungary's 1.3 percent.² Yugoslavia's economic performance also improved with a 1.7-percent growth in GNP, a significant recovery from the previous year's 1.3-percent decline. Although the region's overall performance was the best in this decade, growth rates are still well below the relatively high levels of the early 1970s. []

Last year's economic gains resulted largely from good weather that helped push agricultural production to record levels in most of the region. Every country except Bulgaria harvested a record grain crop,³ but Bulgaria's crop was still a substantial improvement over its 1983 results. The increase in grain production—following two years of above-average harvests—and improved output of many nongrain crops supported strong growth in livestock production. As a result, CEMA 6 agricultural output grew 6.2 percent and Yugoslav production was up 1.1 percent. []

¹ The CEMA 6 are Bulgaria, Czechoslovakia, East Germany, Hungary, Poland, and Romania. []

² We estimate Romanian GNP growth at 4.3 percent, but, because of the large distortion in the underlying official indexes, we have less confidence in this estimate than in those for the other countries. []

³ Romania has reported a harvest of 23.6 million metric tons, but we estimate that actual output was closer to 18.1 million metric tons. []

Although industry's gains lagged agriculture's, East European industry continued to recover from its 1981-82 downturn. CEMA 6 industrial output grew 2.9 percent last year, up slightly from 1983's 2.6-percent growth, while Yugoslavia's industrial growth rate rose from 1.4 percent to 1.8 percent. Hungary and Czechoslovakia, which had the poorest performance in 1983, recorded the largest improvements last year. Poland led the region in industrial growth for the second consecutive year, even though the rate of increase slowed from 5.2 percent in 1983 to 4.1 percent last year. Poland's high rate of growth is largely a rebound from the severe depression of 1980-82 when industrial production fell slightly over 15 percent. []

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Some easing of external problems as well as adjustment to reduced Western imports and Soviet oil deliveries underlie the modest revival of East European industry. Economic recovery in the West helped boost hard currency exports 7 percent in dollar terms. This increase in sales and a greater availability of trade financing allowed all of the regimes, except Hungary, to ease import restraints imposed during the 1981-83 financial crisis. Although hard currency imports remained well below their 1980 peak, last year's small increase probably improved domestic supplies of key raw materials and manufactured goods, helping to ease bottlenecks and support the upturn in industrial production. Planners also have probably shifted production and distribution patterns somewhat, enabling the East European economies to substitute domestic production for goods previously imported from the West and to conserve on the use of materials. Moreover, East Germany, and to a lesser extent Hungary and Czechoslovakia, which suffered cutbacks in Soviet oil deliveries after 1981, have achieved some success in energy conservation and substitution. []

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The consumer, whom most East European regimes had already favored over investment in adjusting to financial problems, benefited further from last year's pickup in economic growth. Poland recorded the

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Table 1
Eastern Europe: GNP Growth

Average annual percentage growth

	1971-75	1976-80	1981-82	1983	1984 ^a
Bulgaria ^b					
Total GNP	4.7	1.0	2.9	-1.6	3.1
Agriculture	2.2	-3.4	5.2	-12.4	7.5
Industry	5.7	3.4	2.5	1.9	2.3
Other	5.7	1.6	1.9	1.2	1.7
Czechoslovakia ^c					
Total GNP	3.4	2.2	0.7	1.0	2.3
Agriculture	2.4	1.4	-0.4	1.7	4.2
Industry	3.9	2.8	1.4	0.9	2.5
Other	3.3	1.9	0.4	0.8	1.4
East Germany ^b					
Total GNP	3.5	2.3	0.8	1.6	3.3
Agriculture	2.8	0.7	0.8	3.1	10.0
Industry	3.4	3.0	1.7	1.9	2.0
Other	3.7	2.2	-0.1	0.8	2.6
Hungary ^d					
Total GNP	3.3	2.0	2.2	-1.2	1.3
Agriculture	3.9	1.6	5.8	-5.8	2.1
Industry	2.6	2.2	1.6	1.0	2.1
Other	3.5	2.1	0.7	-0.3	0.3
Poland ^c					
Total GNP	6.5	0.6	-3.2	4.6	3.4
Agriculture	1.1	-1.0	4.4	4.7	3.9
Industry	7.6	0.6	-7.9	5.2	4.1
Other	10.0	1.8	-3.9	4.2	2.7
Romania ^c					
Total GNP	6.7	3.9	1.5	0.2	4.3
Agriculture	5.3	3.2	4.1	-0.3	11.4
Industry	9.2	4.4	0.8	3.1	3.8
Other	5.4	3.9	0.2	-2.6	-1.2

fastest growth rate in private consumption—5.1 percent—as the government backed away for the second consecutive year from stringent austerity measures in order to curry popular support and to show progress in resolving the country's economic problems. East Germany and Czechoslovakia recorded increases in consumption on a par with those of the 1970s while Hungary at least recouped 1983's losses. Only Yugoslavia showed a statistical decline in

personal consumption, although the Romanian population probably in fact suffered a far worse fall in living standards. Although private consumption was up for the region as a whole, imbalances continued in consumer markets resulting in shortages, price hikes, and—in Poland and Romania—rationing of some food and consumer goods.

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Table 1 (continued)

Average annual percentage growth

	1971-75	1976-80	1981-82	1983	1984 ^a
CEMA ^c					
Total GNP	4.9	1.9	0.0	1.6	3.1
Agriculture	2.5	0.4	3.5	0.6	6.2
Industry	5.5	2.4	-1.0	2.6	2.9
Other	5.7	2.2	-0.9	1.3	1.6
Yugoslavia ^d					
Total GNP	6.1	5.6	1.1	-1.3	1.7
Agriculture	2.9	2.2	5.6	-1.8	1.1
Industry	5.8	7.2	1.0	1.4	1.8
Other	7.6	5.8	-0.3	-2.9	1.8

^a Preliminary.^b At 1975 adjusted factor cost.^c At 1977 adjusted factor cost.^d At 1976 adjusted factor cost.^e At constant 1984 dollars.

Note: Caution must be used when viewing the rates of growth for total GNP and by sector of origin for the CEMA 6. While they are useful in illustrating individual country differences from the "average," their primary shortcoming stems from the fact that they are an artificial measure that is the combination of individual countries measured in different factor costs. This difference in factor costs means that a dollar's worth of output in one country (say Bulgaria) is not equal to a dollar's worth of output in another country (say Czechoslovakia).

Growth rates for investment were much more mixed than those of consumption. Although tight control on investment since 1980 has raised concern in Eastern Europe about long-term growth, East Germany, Hungary, Bulgaria, and Yugoslavia continued to limit, if not reduce, investment to free up output for export and consumption. Poland, Romania, and Czechoslovakia accelerated investment, but much of this spending went to reviving large, heavy industrial projects that will probably have little, if any, payoff. Many of these projects were ill conceived from the outset and due to the long leadtime for completion will be technologically obsolete.

1985: Recovering From a Bad Start

Last year's economic upturn probably will not carry over to 1985 for most of the East European countries.

The region was hit by extremely harsh winter weather that led to energy shortages, disruptions in transportation and production, poor hard currency trade performance, and damage to winter grain crops in Bulgaria and parts of Romania. the region generally is recovering from the first-quarter losses in production and trade, but the more hard-hit and fragile economies are still struggling:

- Romania is unlikely to match last year's growth rates. Lack of energy reserves may have cut industrial production as much as 7 percent compared with first quarter 1984, and worsening payment problems have led the regime to slash

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Comparing Official and Reconstructed Growth in Eastern Europe

Understanding the methods used to measure East European economic growth is essential to understanding the region's economic performance. The two measures used most frequently are the official national income produced (NIP) used in Marxist national income accounts and gross national product (GNP) as conventionally measured in Western practice.

These two measures of economic growth, NIP and GNP, differ in three ways: services, prices, and depreciation. Marxist national income accounts—unlike GNP measures—exclude as nonproductive most services, including housing, education, government administration, and consumer services. Prices also distort Marxist national income accounts. Goods are valued in purchasers' prices that include turnover taxes—taxes on sales to consumers which vary from item to item. Western-style GNP accounts, on the other hand, value goods and services at factor cost—the value of labor and capital services used in their production. A change in turnover taxes will, therefore, affect Marxist national income, but not Western-style GNP. NIP measures also suffer an upward bias resulting from underestimation of price increases in official indexes. This upward bias is due to two factors: (1) the declining quality of goods while their prices remain the same and (2) the introduction

of new products whose prices are set excessively high, although the new product may be in reality an older product with some insignificant alteration. The difference in the third area is that GNP measures do not deduct depreciation from gross fixed capital formation while Marxist national income measures do.

As a result of these accounting differences, growth rates measured in Western-style GNP terms differ markedly from growth rates expressed in Marxist national income terms. Movement in Western-style GNP growth measures tends to be less extreme than their Marxist counterparts because services, excluded from Marxist accounting practices, usually are more stable on a year-to-year basis than the other components of production.

	GNP	NIP
Bulgaria	3.1	4.6
Czechoslovakia	2.3	2.8
East Germany	3.3	5.5
Hungary	1.3	2.8 to 3.0
Poland	3.4	5.1
Romania	4.3	7.7

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already sparse imports and redouble its export drive. Because of weather problems and shortages of inputs, the outlook for agricultural production is mediocre.

- Poland's economy had its worst start since 1982. Data for the first quarter indicate industrial production stagnated and the hard currency trade surplus fell to \$250 million for \$360 million in the same period last year. While results from April and May show growth in industrial production, Polish officials are pessimistic about this year as a whole.

- Bulgaria seems likely to turn in one of its poorest economic performances in years. The regime's effort to make up for weather-related production losses through a six-day workweek does not seem to be yielding encouraging results. Agricultural performance will likely suffer due to continuing drought and low reservoir levels.

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Table 2
Eastern Europe:
Private Consumption

*Average annual
percentage growth*

	1971-75	1976-80	1981-82	1983	1984
Bulgaria	3.8	1.6	3.2	0.5	1.7
Czechoslovakia	2.7	1.6	0.8	0.9	2.0
East Germany	3.9	2.0	0.2	0.5	3.7
Hungary	3.3	2.2	1.3	-0.8	1.0
Poland	5.5	2.4	-5.6	5.2	5.1
Romania	5.1	4.7	0.4	-1.9	NA ^a
Yugoslavia	5.2	4.9	-0.5	-1.7	-2.0

^a The Romanian Statistical Office has ceased publication of key data necessary for the calculation of private consumption.

- Yugoslavia's goal of recording major gains over 1984 has been dashed, although some growth is likely. Industrial production slumped during the first quarter while a falloff in exports and an increase in imports produced a hard currency account deficit of \$359 million through April in contrast to a \$31 million surplus in the same period of 1984.

- Czechoslovakia, East Germany, and Hungary will probably come close to matching last year's economic performance. Although all of these economies were affected by the harsh weather, overtime and other administrative measures have helped overcome the first-quarter deficiencies.

Prospects

Although this year's downturn is largely related to the unusually harsh winter, external factors and systemic weaknesses will limit economic growth for the rest of the decade. We doubt that the region can sustain GNP growth of more than 2 percent annually over the next few years, far below the growth rates obtained during the 1970s:

- The East Europeans will face strains in their economic relations with both the West and the USSR. Large hard currency debt service requirements and caution among Western creditors

Table 3
Eastern Europe:
Gross Fixed Investment

*Average annual
percentage growth*

	1971-75	1976-80	1981-82	1983	1984
Bulgaria	8.6	6.1	6.1	0.4	1.0
Czechoslovakia	8.3	3.0	-3.5	0.6	4.4
East Germany	4.8	3.4	-1.3	0.0	0.0
Hungary	7.0	2.4	-3.7	-2.7	-1.0
Poland	18.5	-3.0	-17.5	9.4	8.0
Romania	11.4	8.5	-5.5	2.9	6.1
Yugoslavia	5.8	5.5	-7.7	-10.0	-6.0

over new lending to some countries will continue to limit imports and require improved export performance. At the same time, the East Europeans can no longer count on Soviet economic largess in the form of large price subsidies and ruble trade deficits. To bring the economic relationship into closer balance, Moscow is insisting that the East Europeans provide more and better quality goods, along with investment resources, in return for energy and raw material exports.

- Growth of inputs needed to sustain economic growth will be slow. In all the countries except Romania, the rate of growth in the labor supply will decline during 1986-90. Because of external constraints and unease over reductions in domestic consumption, most regimes will probably keep investment rates below historical levels, limiting improvements in productivity. Moreover, none of the East European economies has addressed the problems of sectoral misallocation of investment and excessive inventories resulting from negative real interest rates, distorted prices, lack of financial sanctions on inefficient operations, and the desire to hoard resources to meet plan targets.

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- Most of the countries suffer from low energy reserves and inefficient energy-intensive industries, and the possibility of more reductions in Soviet oil deliveries is always present.
- While most of the regimes recognize the inefficiency of their economic systems, only Hungary has undertaken meaningful action to decentralize decisionmaking, rationalize prices, or increase the role of market forces in the economy. Hungary's economic performance, however, is not an unequivocal testament to the success of reform. Although the Soviets are pressing the East Europeans for greater economic efficiency, most regimes appear uncertain about the degree of reform Moscow is willing to permit and are unlikely to do more than tinker with their existing systems.

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Given this outlook, the East European regimes will face tough decisions allocating the limited growth of output between the competing uses of investment, consumption, defense, and exports.

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Economic News in Brief

Western Europe

Recovery in energy trade balance gave Britain a trade account surplus in May for the first time since February 1984 . . . stronger trade performance plus healthy invisibles earnings will likely push 1985 current account surplus above last year's \$833 million, but still well below the \$6.8 billion surplus in 1982-83 . . . might enhance investors' confidence in the British economy and lead to a further strengthening in the pound. []

Prime Minister Thatcher stated on 8 July more spending cuts may be necessary so tax cuts can be made . . . falling oil prices, rising inflation, and high public-sector wage settlements threatening to postpone tax cuts . . . London is under increasing pressure to deliver on promised cuts to help alleviate the unemployment problem. []

Almost three times as many new French high-tech businesses succeeded as failed between 1980 and 1983, compared to a ratio of about 1.7 for non-high-tech firms, according to the Small and Medium-Sized Business Equipment Bank . . . during that period the number of high-tech firms increased by 76 percent . . . most new firms are in Paris or in the south and southwest. []

Ankara eliminated foreign exchange restrictions on commercial banks at end of June . . . previously, banks could buy and sell foreign exchange only within a 6-percent band around the Central Bank's official rate . . . move is another step toward convertibility of the lira and is aimed at dampening money growth by reducing pressure on the Central Bank to buy foreign exchange. []

Eastern Europe

Hungary considering creating automobile industry . . . only CEMA country without production capability . . . present stock of cars aging with this year's supply expected to be nearly 40 percent below demand . . . shortage of hard currency and difficulties with CEMA suppliers prevent increase of imports. []

Bulgaria has arranged its first syndicated credit since 1979 . . . seven-year loan offered originally for \$100 million, but Western banks responded so eagerly that the amount was raised to \$200 million . . . Sofia enjoys a good standing with bankers because of small debt and reputation for financial conservatism. []

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